



# City of Morgan Hill

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**File #: 15-213, Agenda Date: 5/6/2015, Version: 1**

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## **SUPPLEMENTAL CITY COUNCIL STAFF REPORT MEETING DATE: MAY 6, 2015**

PREPARED BY: Edith Ramirez, Economic Development Manager  
APPROVED BY: City Manager

### **GPA-14-04: BUTTERFIELD-MWEST ADDITIONAL INFORMATION**

#### **RECOMMENDATION(S):**

Accept additional information

#### **NARRATIVE:**

At the February 18, 2015 City Council meeting, the Council asked staff to update the industrial land supply study performed by Strategic Economics to help create the most accurate picture of industrial land use in Morgan Hill and provide data regarding supply as result of market absorption and General Plan conversions; those occurring in the past two years and those proposed in the General Plan.

As referenced in the staff report for the Butterfield-MWest GPA, attached is the Industrial Land Update of available industrial land and buildings to accommodate future employment growth in Morgan Hill. This update addresses the changes in the economy since the 2013 "Economic and Fiscal Impact Analysis of Industrial Land Conversions." The report offers a comparative analysis of four scenarios: 1) land supply in 2013, 2) existing land supply (2015), 3) expected land supply with the proposed General Plan Update changes and 4) expected land supply with the proposed General Plan Update changes and proposed General Plan Amendments.

Highlights from the report include:

- The total square feet of R&D, Industrial, Warehouse and Office space in Morgan Hill is 6,238,972.
- R&D and Industrial space comprise 80% of all buildings.
- The current vacancy for industrial and R&D space is less than 3%.
- The existing vacant industrial land today is 247 acres; this represents a reduction of 37 acres since 2013. This land supply represents 30 to 77 years of supply for the city, depending on whether a historic rate is assumed or whether ABAG employment assumptions are assumed. The range in supply reflects the use of two statistical assumptions. On the low end, the

number represents Morgan Hill's historical absorption rate; the high rate utilizes ABAG's assumption of employment growth for Morgan Hill.

- The Cochrane Road area (sub areas 1, 2, and 3) continue to be the strongest location for future industrial R&D and office uses.
- When using historic rate of absorption, the industrial supply citywide is projected to last 30 years without any changes. This supply decreases to 19 years with the General Plan Update and the proposed General Plan Amendments.
- Area Three, the location of the proposed MWest land conversion, is projected to have a land supply for nine years when using the historical rate of absorption and only six years after the proposed General Plan Update and proposed General Plan Amendments.
- If the General Plan Update and the proposed General Plan Amendments are approved, the industrial land supply for the entire city would drop to 19 to 48 years.

Below is a table that summarizes the findings by area:

Vacant Land (acres)	Vacant Land 2013	Supply in Years 2013	Vacant Land 2015	Supply in Years 2015	Vacant Land after GPU	Supply in Years after GPU	Vacant Land after GPU & GPAs	Supply in Years after GPU & GPAs
<b>Total</b>	284	40-95	247	30-77	204	25-64	149	19-48
<b>Sub Area 1</b>	38	10-25	29	5-13	29	5-13	29	5-13
<b>Sub Area 2</b>	30	10-20	32	5-14	32	5-14	32	5-14
<b>Sub Area 3</b>	89	20-40	63	9-23	56	8-21	36	6-15
<b>Sub Area 4</b>	97	20-40	87	12-30	87	12-30	52	8-20

The study performed by Strategic Economics was a result of interviews with local brokers and developers and market data from Colliers International that tracks this market closely.

Also included as part of this Supplemental Report, attached is the Environmental Impact Report (EIR) Certification Resolution for MWest. In addition, MWest has supplied additional findings for a statement of overriding considerations in the event that the Council wishes to approve their general plan amendment request, as well as a letter prepared by Colliers International related to Projected Demand for New Construction in the Morgan Hill Industrial Market for Council consideration.

Finally, an updated EIR certification resolution has been provided in the event that the Council wishes to certify the EIR previously prepared by the applicant without taking any action on their general plan amendment request. Certifying the previously prepared EIR does not in any way approve the general plan amendment; it simply provides that, in the independent judgment of the City, the analysis contained in the EIR was prepared in accordance with the requirements of CEQA.

**LINKS/ATTACHMENTS:**

1. MWest's proposed supplement to the Statement of Overriding Considerations
2. MWest's letter prepared by Colliers re: Projected Demand for New Construction in Morgan Hill Industrial Market
3. Environmental Impact Report (EIR) Certification Resolution for MWest
4. Strategic Economics Industrial Land Update

## MEMORANDUM

Date: May 5, 2015

To: Edith Ramirez, City of Morgan Hill

From: Sujata Srivastava, Strategic Economics

Subject: Morgan Hill Industrial Land Study Update (#1212b)

### Introduction

This memorandum report is an update of the calculation of available industrial land and buildings to accommodate future employment growth in Morgan Hill, building on the 2013 “Economic and Fiscal Impact Analysis of Industrial Land Conversion” report. Since the completion of the 2013 report, the City’s available supply of industrial land and buildings has changed, due to three major factors:

- 1) General Plan Amendments were approved, are pending, or incorporated into the General Plan Update that resulted or may result in the conversion of properties from industrial to residential uses.
- 2) A significant amount of the available vacant industrial, R&D, and office space has been absorbed since 2013.
- 3) The General Plan Update currently underway will re-designate some parcels that were formerly zoned for “industrial” uses to “flex” uses, which would allow them to be developed as retail commercial sites.

This study provides a revised calculation of the potential supply of industrial space, with new estimates of land supply and available buildings. The calculation of the projected demand for employment space has not changed since 2013. Strategic Economics compared projected demand for employment space with supply. The results are expressed as “years of supply,” or the ratio of the total potential supply in each scenario to projected annual average demand for employment space.

### Summary of Findings

#### Existing Industrial Areas

The industrial employment lands in Morgan Hill are located in four major subareas. Subarea 1 is the Morgan Hill Ranch Business Park, located south of Cochrane Road and east of Butterfield Boulevard. This area houses the city’s largest employers and is considered a core employment area. Subarea 2 is located north of Cochrane Road, bounded by Highway 101 to the east and Monterey Road on the west, and is also considered a core employment area. Subarea 3 is located in the Morgan Hill Ranch Business Park west of Butterfield Boulevard, housing the largest available vacant industrial sites. It also contains the South Bay parcel on Cochrane Road. Subarea 3 is considered a future employment area. Subarea 4 is the industrial district south of Dunne. This area contains heavier industrial users and is defined as an established industrial area.

**The Cochrane Road area (Subareas 1, 2, and 3 in Figure 1) continues to be the strongest location for future industrial, R&D, and office uses.** Home to most of Morgan Hill's largest employers, Subareas 1 and 2 include most of the city's newest and largest industrial and commercial buildings, and are most attractive for businesses considering moving to Morgan Hill. Subarea 3 includes some of the largest vacant properties under consolidated ownership, including multiple large, vacant properties on the west side of Butterfield Boulevard. Given the competitive advantages of the Cochrane Road area, this subarea would be a natural location for a large business looking to move to Morgan Hill in the future, particularly as the remaining supply of vacant land in Subareas 1 and 2 are developed over time.

**The area south of Dunne Avenue (Subarea 4 in Figure 1) plays an important role in Morgan Hill's economy by providing relatively low-cost space for small manufacturers and other businesses.** This area is well established for smaller industrial uses, and offers fewer opportunities for large-scale commercial or industrial development when compared to the Cochrane Road industrial subareas.

### Demand for Employment Space in Morgan Hill

**Morgan Hill has a significant and growing employment base.** The city has a strong manufacturing and wholesale employment base, and the city's economy shows signs of diversifying, with recent increases in office-based sectors including health and education, finance, insurance, real estate, and information. Continued population growth could also drive continued growth in health and education, finance, insurance, and real estate, since these industries often serve residents. Employment forecasts range from 155 to 370 new jobs per year in Morgan Hill.

**The commercial real estate market in Morgan Hill is strong, particularly for industrial and R&D uses.** The total amount of vacant space has declined by half since 2013. According to Colliers International, the vacancy rate for industrial and R&D uses is under three percent (see Figure 2). The office market remains soft in Morgan Hill, with a vacancy rate of 18 percent vacancy rate. However, the overall commercial real estate market for all the above land uses is much stronger today than in 2013, with a combined vacancy rate of four percent. All land uses experienced positive absorption during 2014.

**Existing industrial tenants in Morgan Hill are actively seeking space for expansion.** Existing employers in Morgan Hill have plans to lease more industrial space in the next two years (approximately 100,000 square feet), and speculative industrial projects have been proposed that would add new space to the market for new and existing users.

### Supply of Industrial Land

The supply projections were calculated under four scenarios, and are shown in Figure 3, 4, 5, and 6:

- Scenario 1 summarizes the previous 2013 study (Figure 3).
- Scenario 2 summarizes existing land supply using updated 2015 data (Figure 4).
- Scenario 3 shows the industrial land supply with the proposed General Plan Update, which would re-designate some industrial land for flexible commercial uses (Figure 5).
- Scenario 4 shows the supply with both the General Plan Update and the approval of General Plan Amendments to convert industrial lands to other uses (Figure 6).

**Today, the total number of acres of vacant industrial land located within the city is lower than the supply in 2013, sufficient to accommodate projected demand for approximately 30-77 years.** In other words, the total potential supply of industrial, R&D, warehouse, and office space is enough to satisfy between 30 and 77 years of commercial demand, depending on the pace of job growth (Figure 4).

**Within the Cochrane Road subareas, the 2015 land supply can accommodate growth for 16 to 41 years, a slight decrease from 2013.** As employment growth occurs within Morgan Hill, the Cochrane Road business park area is likely to continue to be the most competitive for attracting new employers and, in the longer-term, new development (Figure 4).

**The proposed General Plan Update would reduce the total supply of land for employment uses to 25 to 64 years in Morgan Hill.** In the Cochrane Road area, the land use changes envisioned in the General Plan Update would reduce the total inventory to 15 to 39 years of supply (Figure 5).

**The combined General Plan Update and the General Plan Amendments seeking conversion of industrial properties further reduces supply citywide to 19 to 48 years.** In the Cochrane Road area, the industrial land supply would meet commercial demand for between 13 and 33 years (Figure 6).

#### Development Potential

**If rental rates continue to rise as expected, the potential for larger scale development of industrial, R&D, and office space is likely to become feasible in the short term.** According to local brokers and developers, the overall rental rates on industrial and R&D properties are currently about 20 percent lower than what is required to make speculative new construction feasible. However, if rental rates in the Silicon Valley continue to climb, it is reasonable to expect that rental rates in Morgan Hill will increase enough to attract new construction. It is possible that the city would receive more development proposals for non-retail commercial space within the next 2-3 years, if job growth in the region continues to be strong.

#### **Assumptions**

The following presents the key assumptions used in the analysis.

- **Employment Growth:** Overall, Strategic Economics projects demand for between 44,700 and 114,000 square feet a year of industrial, warehousing, R&D, and office space, or a total of 805,000 to 2 million square feet by 2030. The 44,700 to 114,000 square foot range represents the projected annual *average* demand over the coming decades; in any given year, demand could be more or less depending on national, regional, and local economic conditions. The low end of the range is based on Association of Bay Area Government's 2012 projections, which forecast that Morgan Hill's employment will grow by 155 new jobs a year over the thirty year period. This would represent a substantial reduction in the rate of employment growth in Morgan Hill over the past two decades. The high end of the range is based on the historic rate of employment in Morgan Hill between 1990 to 2010, when the City added 370 jobs per year.
- **Demand for New Industrial, R&D, and Office space:** In order to determine how many square feet of industrial, R&D, office, and warehouse space these new employees would require, Strategic Economics distributed the projected employment growth by sector and then by building type. Strategic Economics then converted the employment numbers into demand for building space, using rules of thumb about the number of square feet required for each

employee (500 square feet per worker for industrial space, 800 square feet per worker for warehousing, 300 to 350 square feet for R&D, and 250 to 300 square feet for office).

- **Lot Coverage:** Aerial photographs of the city's newest business parks (e.g. Morgan Hill Ranch and Madrone Business Park) show that recent industrial and commercial development in the city has tended to be one-story high, with the total ground floor area covering no more than 30 percent of the available land area. The analysis assumes that this land use pattern (30 percent coverage ratio, 1-story development) is maintained.
- **Absorption of Existing Vacant Space:** All of the scenarios further assume that 75 percent of the currently vacant buildings in Morgan Hill – about 321,000 square feet – will be absorbed before new development occurs, allowing for some ongoing vacancies caused by friction in the market and obsolescence of some of the existing building stock.
- **Total Potential Building Area:** Includes both the maximum building area that could be developed on the vacant industrial land area considered in the scenario (subject to the lot coverage assumptions discussed above), and the 321,000 square feet of existing inventory that is expected to be absorbed into the market before new development occurs.



Figure 1. Vacant Industrial Land by Subarea, Morgan Hill, 2015

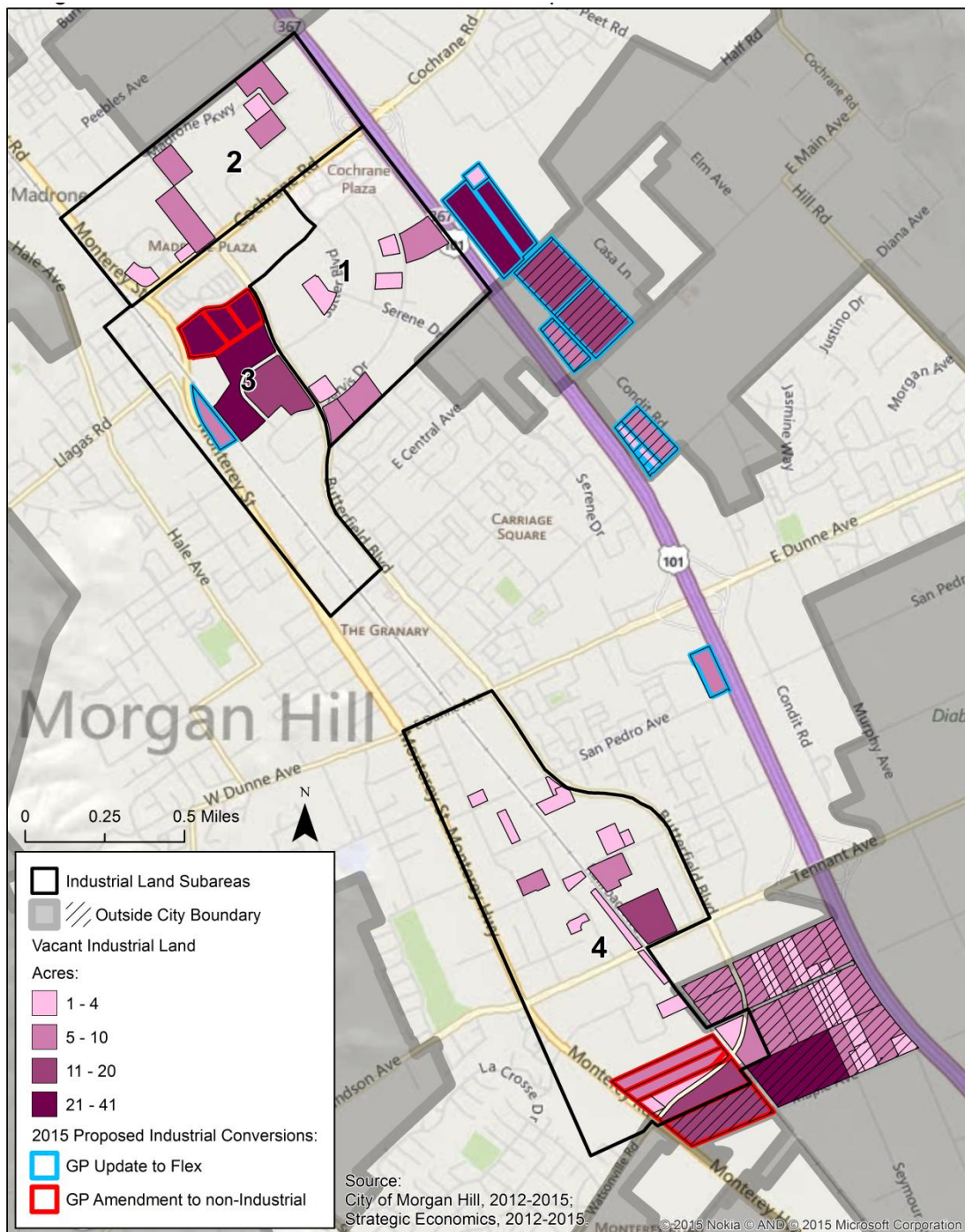




Figure 2. R&D, Industrial, Warehouse, and Office Market Statistics: Morgan Hill, 1<sup>st</sup> Quarter 2015.

Product Type	Total Existing Inventory (1Q 2015)				Vacancy (b)		Net Absorption (c)	
	Number of Buildings (a)	Total Sq. Ft.	% of Total Sq. Ft.	Monthly Rents	Vacant Space 1Q 2015	Vacancy Rate 1Q 2015	1Q 2015	Calendar Year 2014
R&D	66	2,768,135	44%	\$0.95	81,670	2.95%	-22,302	66,146
Industrial	75	2,235,847	36%	\$0.95	56,841	2.54%	17,220	22,251
Warehouse	6	482,538	8%	\$0.49	n/a	n/a	0	28,680
Office	43	752,452	12%	\$1.81	134,739	17.91%	900	47,506
Total	190	6,238,972	100%	\$1.02	273,250	4.38%	-4,182	164,583

(a) Colliers tracks office buildings from 3,500 square feet, R&D from 5,000 square feet, industrial buildings from 7,500 square feet, and warehouse buildings from 10,000 square feet.

(b) Vacancy rate includes vacant direct and sublease space. Because there are only 6 warehouse buildings tracked by Colliers in Morgan Hill, there is not sufficient data to calculate the vacancy rate.

(b) Net Absorption is the net change in occupied space.

(c) Weighted average of full service asking rents, on a per square foot basis (includes all costs associated with occupying the premises).

Sources: Colliers International, 4<sup>th</sup> Quarter 2014 & 1<sup>st</sup> Quarter 2015.

Figure 3. Supply Projections for Scenario 1: Previous 2013 Study

Supply Projection	1. Previous 2013 Study						City and SOI
	City Limits	Subarea 1	Subarea 2	Subarea 3	Subarea 4	Cochrane Road (e)	
Vacant Industrial Land (a)							
In Acres	284	38	30	89	97	167	523
In Square Feet	12,371,040	1,655,280	1,306,800	3,876,840	4,225,320	7,274,520	22,781,880
Maximum Building Coverage	30%	30%	30%	30%	30%	30%	30%
Maximum Building Area (Acres)	85.20	11.40	9.00	26.70	29.10	50.10	156.90
Maximum Building Area (Sq. Ft.) (b)	3,711,312	496,584	392,040	1,163,052	1,267,596	2,182,400	6,834,600
Existing Vacant Industrial, R&D, Office							
Total Vacant Building Area (Sq. Ft.) (c)	808,900	808,900	808,900	808,900	808,900	808,900	808,900
75% of Building Area (Sq. Ft.) (d)	606,700	606,700	606,700	606,700	606,700	606,675	606,675
Total Potential Supply (Sq. Ft.)	4,318,012	1,103,284	998,740	1,769,752	1,874,296	2,789,075	7,441,275
<b>Demand Compared to Supply</b>							
Annual Average Demand (in Sq. Ft.)				44,700 - 114,000			
Years of Supply	40 - 95	10 - 25	10 - 20	20 - 40	20 - 40	25 - 60	65 - 170

Notes:

Columns may not add due to rounding.

(a) Based on City's inventory of zoned industrial parcels in current General Plan, and combined industrial and flex parcels in updated General Plan.

(b) Assumption of 30% site coverage area.

(c) Available space in Industrial, R&D, Office, and Warehouse buildings, Colliers International, 1Q2015.

(d) Assumes that 75 percent of the vacant space would be leased before new construction could occur.

(e) Includes Subareas 1, 2, and 3.

Sources: City of Morgan Hill, 2015; Colliers International, 2015; ABAG, 2012; "Economic and Fiscal Impact Analysis of Industrial Land Conversion," 2013; Strategic Economics, 2015.

Figure 4. Supply Projections for Scenario 2: Existing Conditions, 2015

2. Existing Conditions 2015							
Supply Projection	City Limits	Subarea 1	Subarea 2	Subarea 3	Subarea 4	Cochrane Road (e)	City and SOI
Vacant Industrial Land (a)							
In Acres	247	29	32	63	87	124	464
Maximum Building Area (Sq. Ft.) (b)	3,230,410	378,972	418,176	823,284	1,139,530	1,620,432	6,058,455
Existing Vacant Industrial, R&D, Office							
Total Vacant Building Area (Sq. Ft.) (c)	273,250	273,250	273,250	273,250	273,250	273,250	273,250
75% of Building Area (Sq. Ft.) (d)	204,938	204,938	204,938	204,938	204,938	204,938	204,938
Total Potential Supply (Sq. Ft.)	3,435,347	583,910	623,114	1,028,222	1,344,467	1,825,370	6,263,393
<b>Demand Compared to Supply</b>							
Annual Average Demand (in Sq. Ft.)				44,700 - 114,000			
Years of Supply	30 - 77	5 - 13	5 - 14	9 - 23	12 - 30	16 - 41	55 - 140

Notes:

Columns may not add due to rounding.

(a) Based on City's inventory of zoned industrial parcels in current General Plan, and combined industrial and flex parcels in updated General Plan.

(b) Assumption of 30% site coverage area.

(c) Available space in Industrial, R&D, Office, and Warehouse buildings, Colliers International, 1Q2015.

(d) Assumes that 75 percent of the vacant space would be leased before new construction could occur.

(e) Includes Subareas 1, 2, and 3.

Sources: City of Morgan Hill, 2015; Colliers International, 2015; ABAG, 2012; "Economic and Fiscal Impact Analysis of Industrial Land Conversion," 2013; Strategic Economics, 2015.

Figure 5. Supply Projections for Scenario 3: General Plan Update

Supply Projection	3. Proposed GP Update						City and SOI
	City Limits	Subarea 1	Subarea 2	Subarea 3	Subarea 4	Cochrane Road (e)	
Vacant Industrial Land (a)							
In Acres	204	29	32	56	87	117	362
Maximum Building Area (Sq. Ft.) (b)	2,668,486	378,972	418,176	731,808	1,139,530	1,528,956	4,725,519
Existing Vacant Industrial, R&D, Office							
Total Vacant Building Area (Sq. Ft.) (c)	273,250	273,250	273,250	273,250	273,250	273,250	273,250
75% of Building Area (Sq. Ft.) (d)	204,938	204,938	204,938	204,938	204,938	204,938	204,938
Total Potential Supply (Sq. Ft.)	2,873,423	583,910	623,114	936,746	1,344,467	1,733,894	4,930,457
<b>Demand Compared to Supply</b>							
Annual Average Demand (in Sq. Ft.)				44,700 - 114,000			
Years of Supply	25 - 64	5 - 13	5 - 14	8 - 21	12 - 30	15 - 39	43 - 110

Notes:

Columns may not add due to rounding.

(a) Based on City's inventory of zoned industrial parcels in current General Plan, and combined industrial and flex parcels in updated General Plan.

(b) Assumption of 30% site coverage area.

(c) Available space in Industrial, R&D, Office, and Warehouse buildings, Colliers International, 1Q2015.

(d) Assumes that 75 percent of the vacant space would be leased before new construction could occur.

(e) Includes Subareas 1, 2, and 3.

Sources: City of Morgan Hill, 2015; Colliers International, 2015; ABAG, 2012; "Economic and Fiscal Impact Analysis of Industrial Land Conversion," 2013; Strategic Economics, 2015.

Figure 6. Supply Projections for Scenario 4: General Plan Update and GP Amendments

4. Proposed GP Update and GP Amendments							
Supply Projection	City Limits	Subarea 1	Subarea 2	Subarea 3	Subarea 4	Cochrane Road (e)	City and SOI
Vacant Industrial Land (a)							
In Acres	149	29	32	36	52	97	286
Maximum Building Area (Sq. Ft.) (b)	1,947,132	378,972	418,176	470,448	679,536	1,267,596	3,742,806
Existing Vacant Industrial, R&D, Office							
Total Vacant Building Area (Sq. Ft.)							
(c)	273,250	273,250	273,250	273,250	273,250	273,250	273,250
75% of Building Area (Sq. Ft.) (d)	204,938	204,938	204,938	204,938	204,938	204,938	204,938
Total Potential Supply (Sq. Ft.)	2,152,070	583,910	623,114	675,386	884,474	1,472,534	3,947,743
<b>Demand Compared to Supply</b>							
Annual Average Demand (in Sq. Ft.)	44,700 - 114,000						
Years of Supply	19 - 48	5 - 13	5 - 14	6 - 15	8 - 20	13 - 33	35 - 88

Notes:

Columns may not add due to rounding.

(a) Based on City's inventory of zoned industrial parcels in current General Plan, and combined industrial and flex parcels in updated General Plan.

(b) Assumption of 30% site coverage area.

(c) Available space in Industrial, R&D, Office, and Warehouse buildings, Colliers International, 1Q2015.

(d) Assumes that 75 percent of the vacant space would be leased before new construction could occur.

(e) Includes Subareas 1, 2, and 3.

Sources: City of Morgan Hill, 2015; Colliers International, 2015; ABAG, 2012; "Economic and Fiscal Impact Analysis of Industrial Land Conversion," 2013; Strategic Economics, 2015.

## **RESOLUTION NO.**

### **A RESOLUTION OF THE CITY COUNCIL OF THE CITY OF MORGAN HILL CERTIFYING THE FINAL ENVIRONMENTAL IMPACT REPORT FOR THE BUTTERFIELD-MWEST GENERAL PLAN AMENDMENT PROJECT**

**WHEREAS**, an Environmental Impact Report ("Draft EIR") (SCH Number 2014072009) was prepared for the Project in accordance with the California Environmental Quality Act of 1970, together with regulatory guidelines promulgated thereunder (collectively "CEQA"); a Notice of Preparation ("NOP") was circulated between July 1, 2014 and July 30, 2014 to receive comments regarding the scope and content of the Draft EIR; a public scoping meeting was held on July 28, 2014 to receive oral comments on the NOP and the Draft EIR was circulated between August 26, 2014 and October 9, 2014; and

**WHEREAS**, the City received comments on the Draft EIR by three individuals/organizations, and responses to those comments and minor changes to the Draft EIR were included in a final EIR document (the Draft EIR together with comments and responses received thereto are collectively referred to herein as the "Final EIR"); and

**WHEREAS**, the information contained in the Final EIR was reviewed and considered by the City of Morgan Hill Planning Commission at a duly-noticed Planning Commission public hearing held on November 18, 2014; the Planning Commission took action to recommend to the City Council that the Final EIR not be certified because the project described in the Final EIR was recommended for denial and the Final EIR required Statements of Overriding Consideration to approve the project, but otherwise the Final EIR was found to be complete, correct and in substantial compliance with the requirements of California Environmental Quality Act; and

**WHEREAS**, separate and aside from any action on the project described in the Final EIR, the City Council has been requested to and the Council desires to certify the Final EIR pursuant to the provisions of Section 15090 of the CEQA guidelines.

**NOW, THEREFORE, THE MORGAN HILL CITY COUNCIL DOES HEREBY RESOLVE AS FOLLOWS:**

**SECTION 1: CERTIFICATION OF FINAL EIR:** The City Council hereby certifies that the Final EIR has been completed in compliance with CEQA; that the Final EIR was presented to the Planning Commission and the City Council, and the City Council has reviewed and considered the information contained in the Final EIR prior to taking any actions on the project; and the Final EIR reflects the independent judgment and analysis of the City of Morgan Hill, as lead agency.



**SECTION 2. EFFECTIVENESS.** This Resolution shall take effect immediately upon adoption.

**PASSED AND ADOPTED** by the City Council of the City of Morgan Hill at its meeting held on this \_\_\_\_ day of \_\_\_\_\_, 201\_\_ by the following vote:

**AYES:**

**COUNCIL MEMBERS:**

**NOES:**

**COUNCIL MEMBERS:**

**ABSTAIN:**

**COUNCIL MEMBERS:**

**ABSENT:**

**COUNCIL MEMBERS:**

**DATE:** \_\_\_\_\_

\_\_\_\_\_  
**Steve Tate, MAYOR**

**∞ CERTIFICATION ∞**

**I, Irma Torrez, City Clerk of the City of Morgan Hill, California,** do hereby certify that the foregoing is a true and correct copy of Resolution No.XXXX , adopted by the City Council at the meeting held on , 201\_.

**WITNESS MY HAND AND THE SEAL OF THE CITY OF MORGAN HILL.**

**DATE:** \_\_\_\_\_

\_\_\_\_\_  
**Irma Torrez, CITY CLERK**

January 15, 2015

**VIA EMAIL**

Ms. Kerry Williams  
Mr. Chad Froman  
MWest Properties  
3351 Olcott Street  
Santa Clara, CA 95054

Re: Projected Demand for New Construction in Morgan Hill Industrial Market

Dear Kerry and Chad:

We are writing in response to your request for additional information on the market fundamentals for industrial/R&D product in the City of Morgan Hill, and how MWest's proposal to convert 19.5 acres of land at Butterfield and Jarvis would impact the overall market.

While the current industrial/R&D market is active, and overall vacancy rates are low, the prospect for this market cycle to drive a significant increase in new construction is limited, as evidenced by the historic data we have provided in the attached chart.

As the data indicates, the Morgan Hill industrial/R&D market experiences cycles like the rest of Silicon Valley; however, growth through new development does not occur at a significant pace even during the boom periods. As you know, rents are the primary driver of whether new construction is feasible, not the overall availability of space in the submarket, which is highly variable. Speculative development is not supported by current market rents.

- In order for speculative development of meaningful size to occur, we estimate that **rental rates need to appreciate by at least 35% from current levels** in order for developers to economically justify the risk.
- The major impediment to near term development is that **sales values are currently well below replacement cost**. Sales values have averaged [\$61] per square foot for the past 3 years, which is 60% - 65% below replacement cost (\$150 - \$175 PSF). The average sales price increased in 2014 to [\$93] per square foot, which **remains 38% - 47% below replacement cost**.

The City's existing industrial/office/R&D base is about 5.6 million SF sitting atop approximately 300+ acres of land; of this total, about 2.2 million SF is industrial. Vacancy rates are currently at an overall rate of 3 – 4%. The main driver of the decrease in vacancy rates over the past 12 months has been absorption of for-sale product, not leasing.

- Of the approximately [500,000] square feet of net absorption in the 2<sup>nd</sup> half of 2014, nearly [400,000] square feet **(80%) was users purchasing real estate as opposed to leasing**; favorable financing terms make purchase a highly attractive option.
- Over the past 15 years, industrial and R&D vacancy rates have averaged 10.6% and 11.8%, respectively. Within just two years after the dot-com bubble crash, availability rates (vacant space inclusive of sublease space) for both product types increased from a low of around 1.0% to a high of between 21.0% and 25.0%.

Thus, the existing 5.6 million SF building supply will continue to fluctuate in vacancy in accordance with future market cycles, without undue pressure for new development.

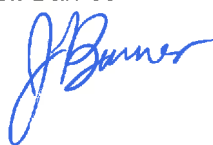
- By our estimates, there are approximately 300+/- developed acres of industrial/R&D/office in the City, and 250+/- acres of vacant land suitable for industrial/R&D/office development in town, for a total base of over 550 acres. **Thus, the City has a sufficient supply of developable land to almost double the current industrial base.**
- Over the past 15 years, including both the dot.com bust period and economic recession, only about 38 acres of land have been developed for industrial space; this translates in to an **average of about 2.6 acres of land absorption per year.**
- Based on this historic rate, **we project the City has a vacant land inventory to last 90 - 100 years**

After learning more about your proposal to develop multi-family apartments west of Butterfield Drive, we think the location is a good one and in fact could help accelerate absorption on the remaining MWest acreage. We have found that anything a City can do to make the area more attractive for businesses and their employees is a positive for the market. Companies are increasingly drawn to land opportunities that offer site design flexibility and are close to affordably priced housing. We all know that Morgan Hill has a dearth of rental housing, so bringing new apartments to the market should bolster the industrial/commercial markets as well.

Please keep us posted on your efforts. In the interim, please do not hesitate to contact us should you have any further questions.

Sincerely,

Jeff Barnes

A handwritten signature in blue ink, appearing to read "JBarnes", written in a cursive style.

## **Economic Benefits**

- The Project would provide a mix of rental and for-sale housing types at a range of costs that meets the needs of all workforce sectors, including workers in the adjacent industrial park.
- The Project would redevelop currently vacant, underutilized land in order to provide housing that is responsive to the City's unmet housing needs.
- The Project would provide multi-family housing in the near term, which is consistent with the City's priority to accommodate higher-density residential projects. Other sites planned for multi-family development have not been implemented due lack of property owner interest and other constraints.
- The Project would provide new residential development that would promote continued growth of the City and provide significant additional growth in retail sales in the City.
- The Project would provide short-term construction jobs and long-term net positive revenue to the City.

## **Social Benefits**

- The Project would establish a well-designed, cohesive development that enhances the gateway to the City located at the nearby Cochrane Road/Monterey Road intersection.
- The Project would create a contiguous residential neighborhood along Jarvis Drive, and would provide a higher-density residential development, that, in conjunction with the residential neighborhood north of Jarvis Drive, would provide a transition and buffer between industrial land uses to the east of the Project site, and lower-density residential areas to the west of Old Monterey Road.
- The Project would provide a landscaped buffer along Butterfield Boulevard and a new roadway between the Project and vacant industrial land located to the south, which would enhance the buffer between residential and industrial land uses in the area.
- The Project would take advantage of a rare opportunity to develop higher-density housing within walking distance of the Morgan Hill Business Park, which is one of the City's main employment centers.

## **Regionwide or Statewide Environmental Benefits**

- The Project would provide both rental and for-sale housing types that would meet the housing needs of various incomes across the region, in a readily accessible location near US 101 and Cochrane Road, which are major thoroughfares within the City providing local and regional access.
- The Project would promote high-density development within walking distance of a major employment center and other services, which would be constructed in compliance with the City's Sustainable Building Regulations, thereby supporting the goal of reducing the region's overall greenhouse gas emissions, consistent with Plan Bay Area, SB 375, and AB 32.